

The Macro-Economic Implications of COVID-19 in our partner countries

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Preliminary remarks

- Welcome
- Who is on the call?
- Countries the Growth Lab is working with, has worked with, is planning to work with
 - Albania, Bolivia, El Salvador, Ethiopia, Jordan, Namibia, Oman, Panama, Peru, Saudi Arabia, South Africa, Sri Lanka, Venezuela, Western Australia
- About Zoom
 - New to the technology
 - Participants window
 - I will mute all
 - You can raise your hand
 - You can unmute yourself to speak
 - Also a chat window: public, private
 - Instability in the transmission: I may temporarily stop when I get a signal of low speed
 - I will be recording the talk
- We are planning to schedule bilateral conversations for any country that wants it, to talk about your specific issues

Introduction

- We are in uncharted waters
- Governments are having to make decisions at a very fast pace, without much time to think
- They are facing difficult moral trade-offs
- There are two elements that make the discussions difficult
- The connection between public health and macroeconomics is weak
 - The virus and the health policies have economic implications that are poorly understood
 - We are now having the first models that combine the two elements
- Macroeconomic policy discussions are centered on the US and advanced countries
 - They do not consider the constraints that are typical in other countries
- In this talk, I want to connect the macroeconomics of developing countries to the COVID-19 shock and derive courses of action for domestic and international policy

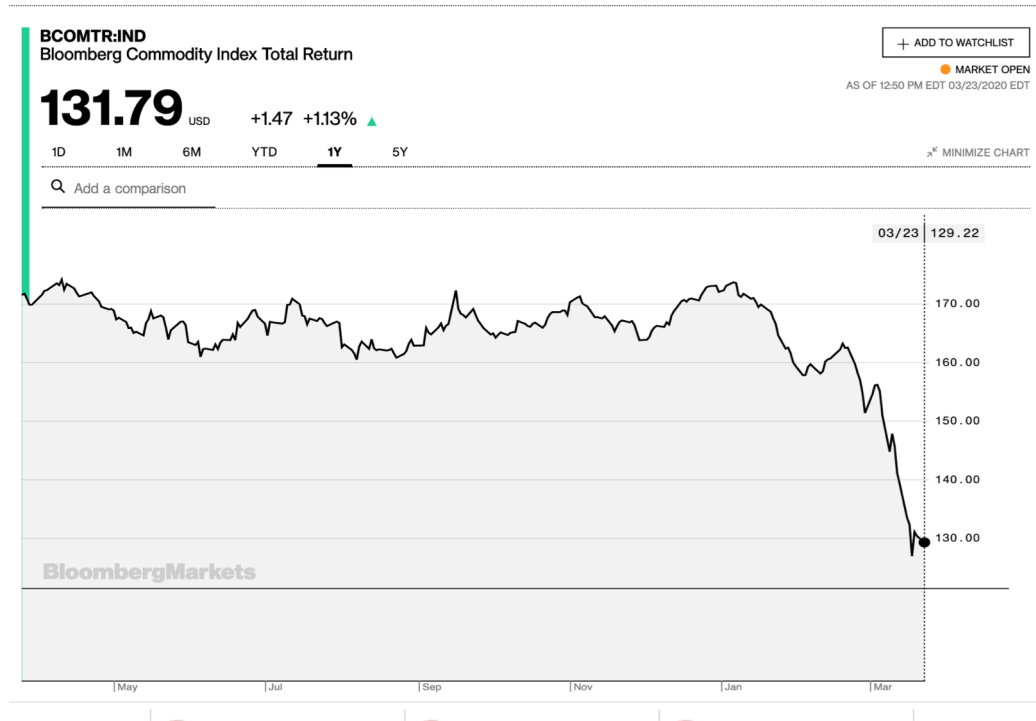
What is happening?

- When it rain, it pours: three simultaneous shocks
- Coronavirus COVID-19
 - How to think about it from an economics perspective?
- Collapse in access to foreign income
 - Collapse in commodity prices
 - Collapse in tourism
 - Expected collapse in remittances
- Collapse in access to capital markets
 - Some countries have no access, others are used to have ample access
 - E.g. Ethiopia vs. El Salvador vs. Australia

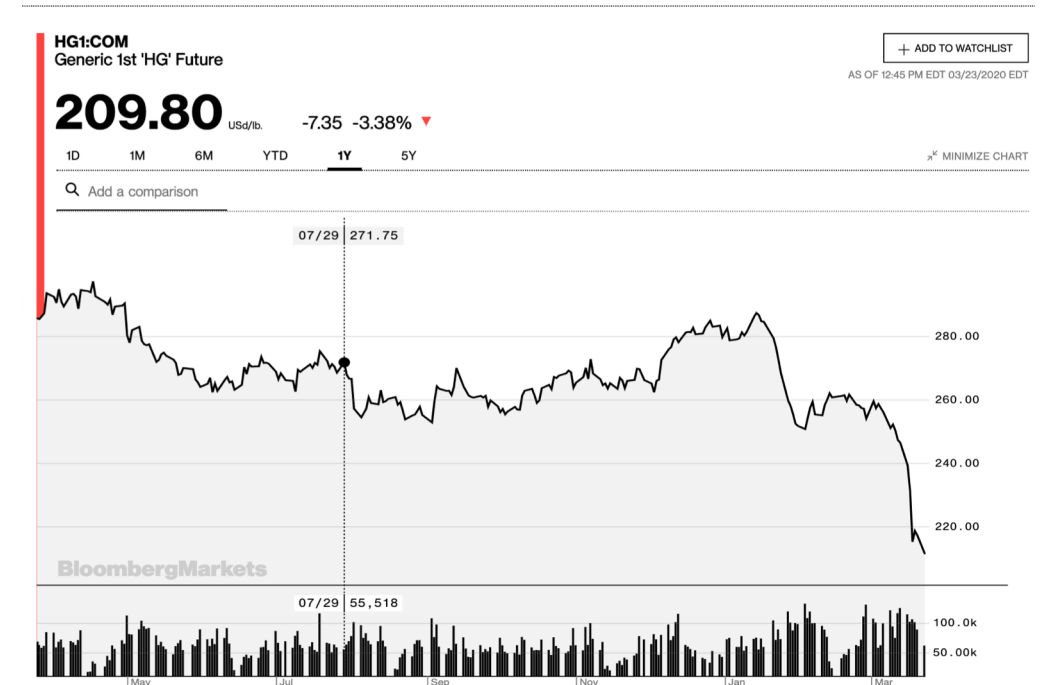
Let us look at the other shocks first

- Commodities
- Tourism
- Remittances
- Capital markets

Commodity prices have taken a large hit



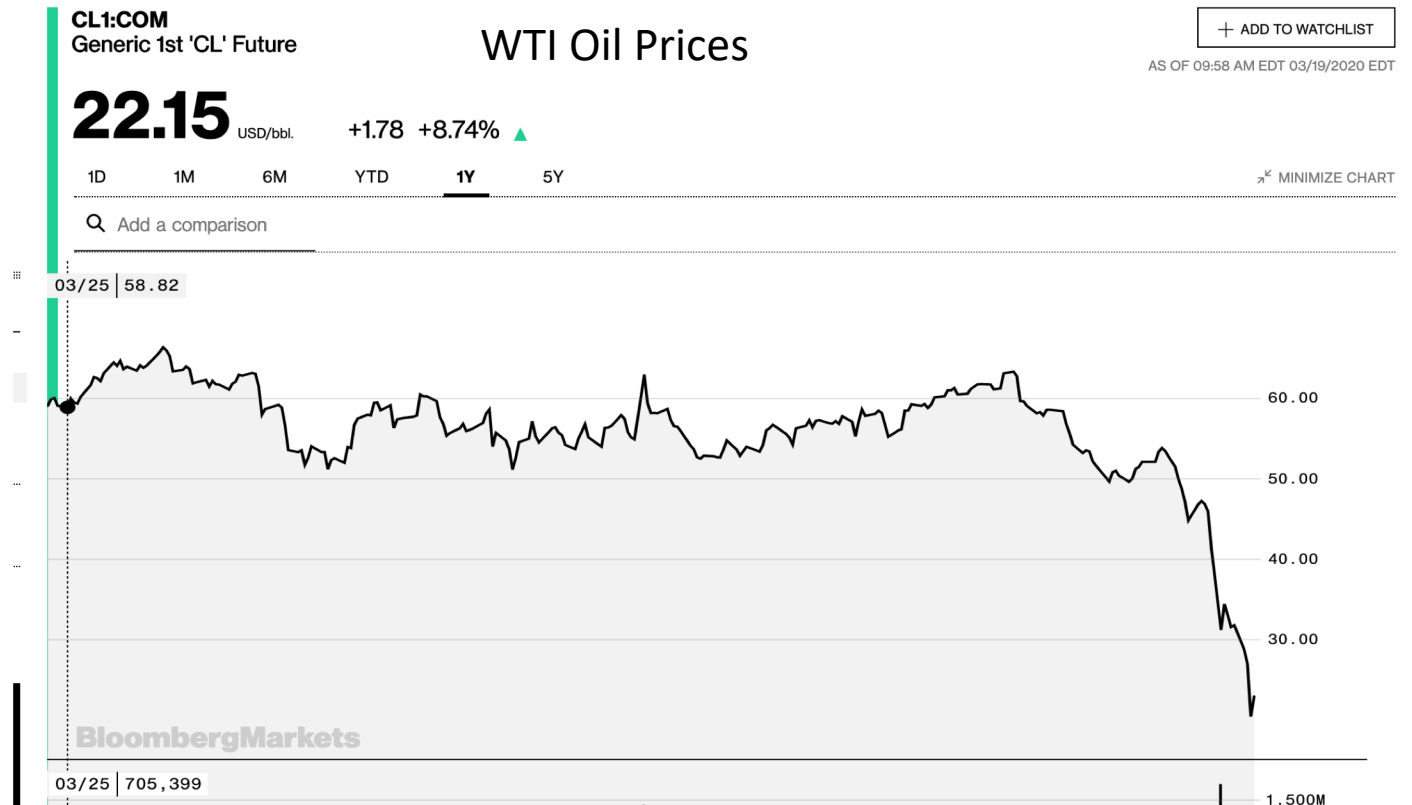
Aggregate commodity index



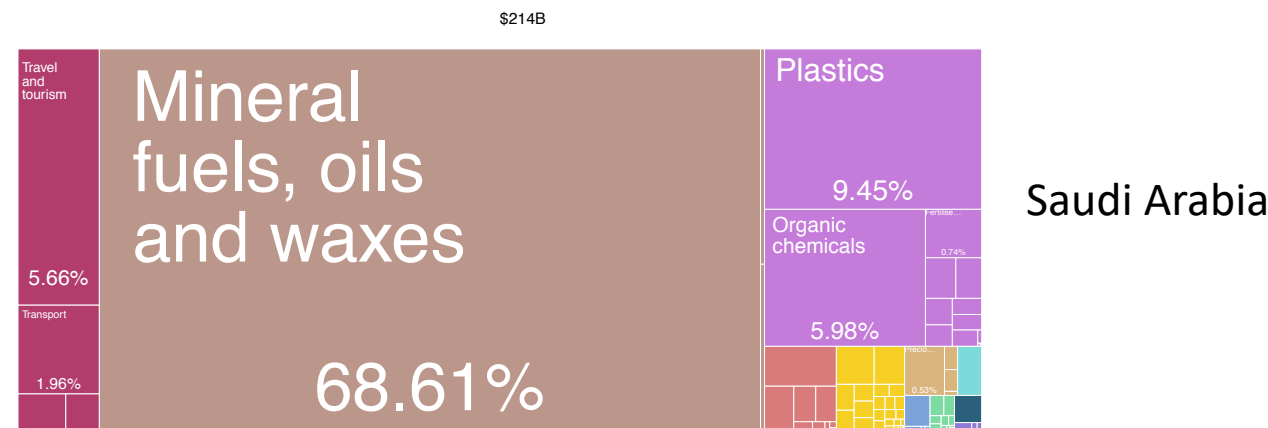
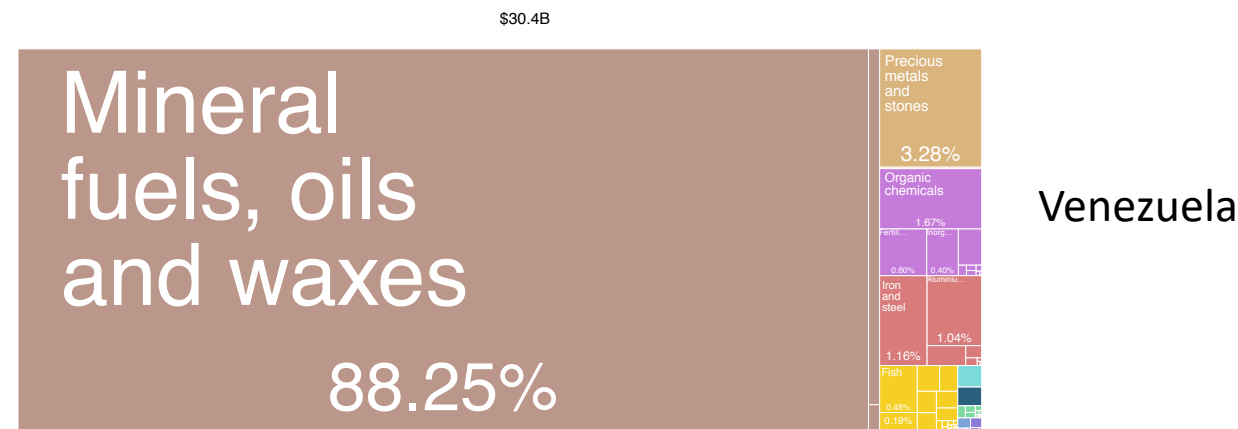
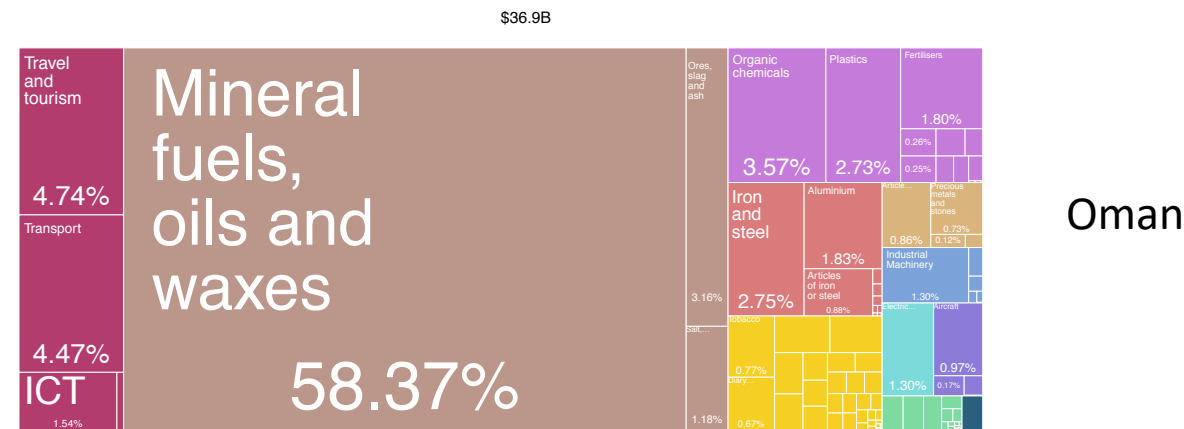
Copper

Oil prices have been hit especially hard

- Oil prices declined to the lowest levels since 2003!!!
- Bad news for oil exporters
- Good news for oil importers

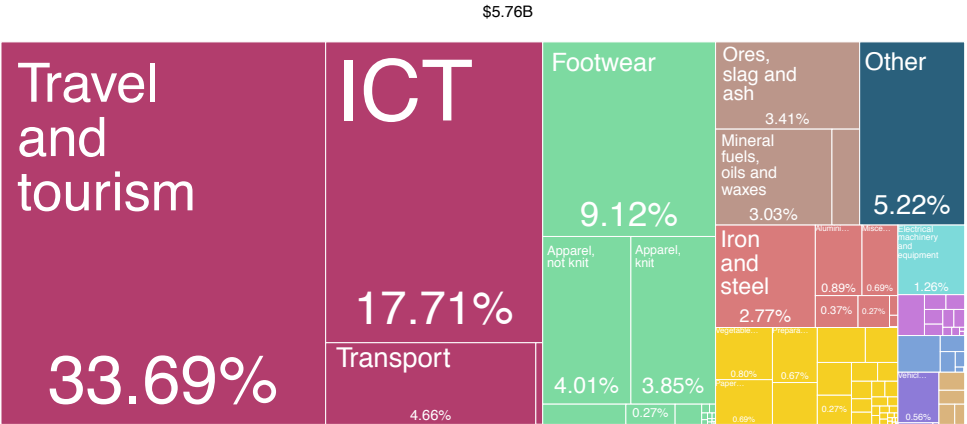


Oil exporters
in the call



Tourism is an important activity in some of countries

Albania

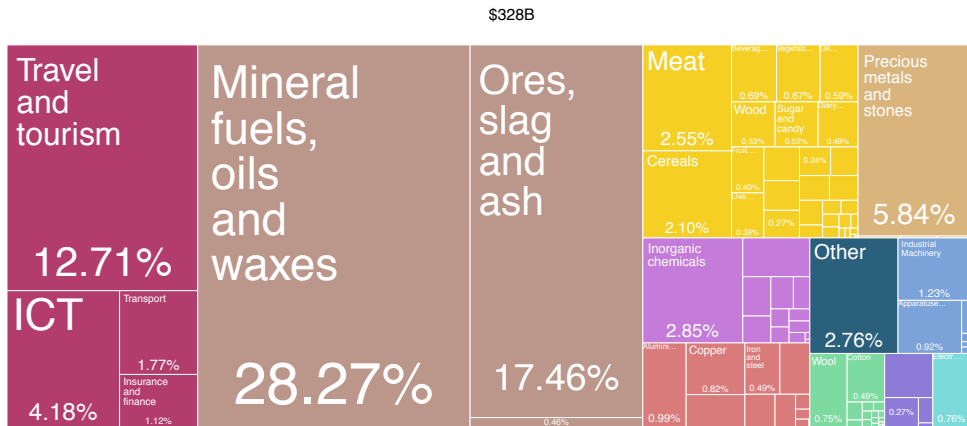


Panamá

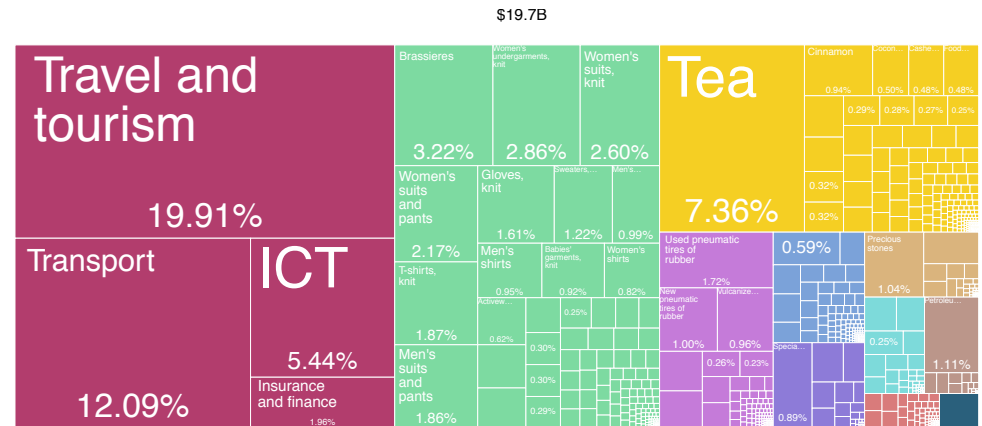


Australia has a mix of mining and tourism

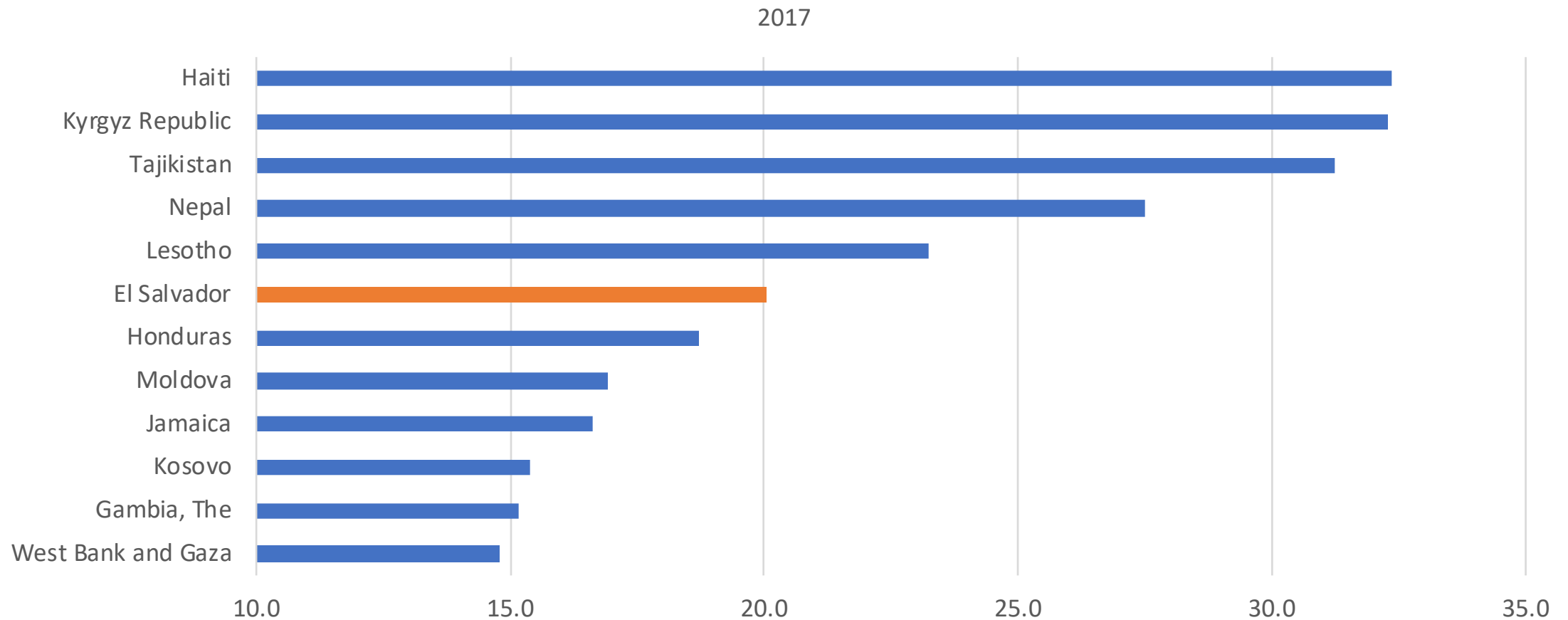
Australia



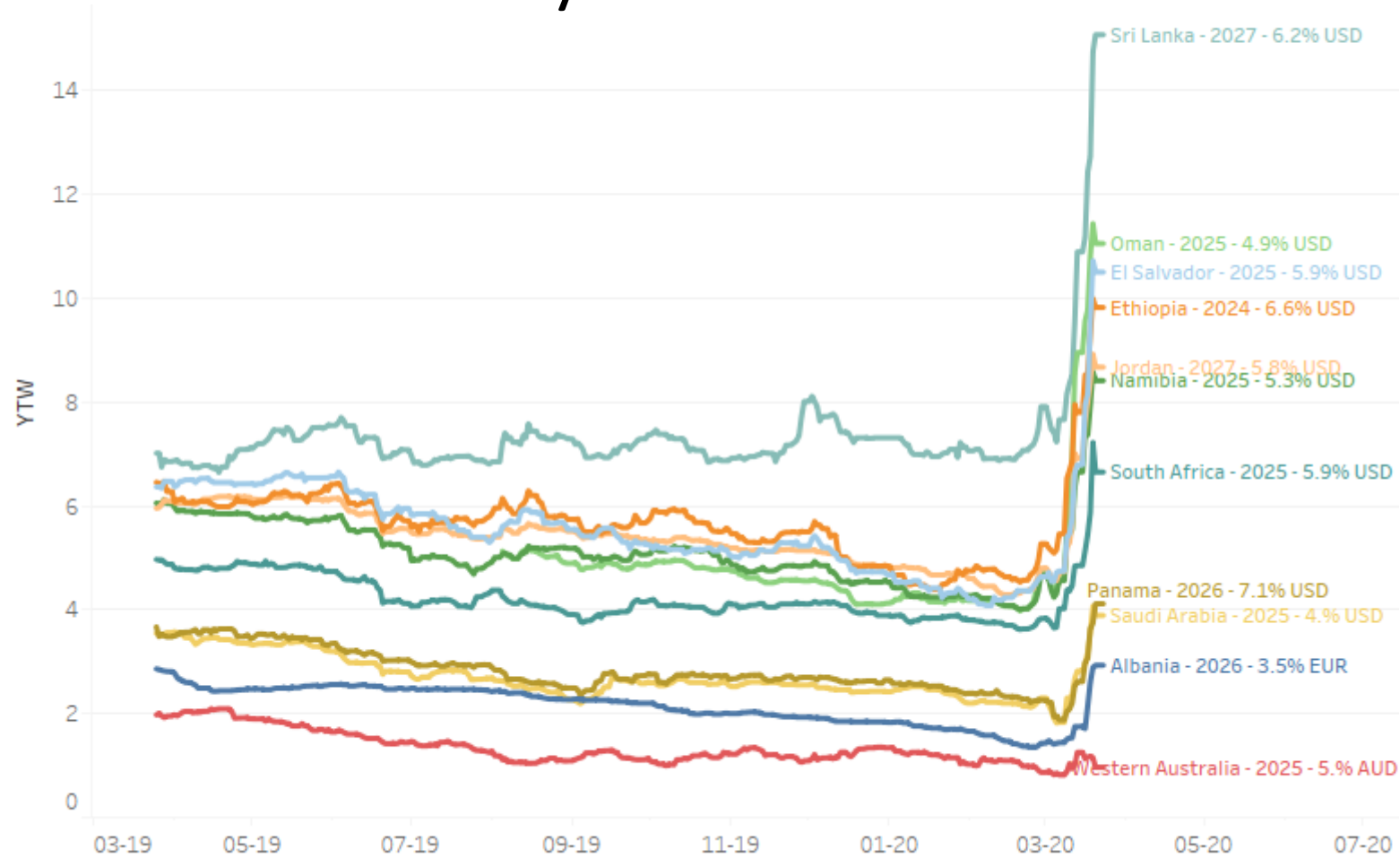
Sri Lanka



Some countries are highly dependent on remittances



Bond yields have sky-rocketed



Source: S&P Capital IQ

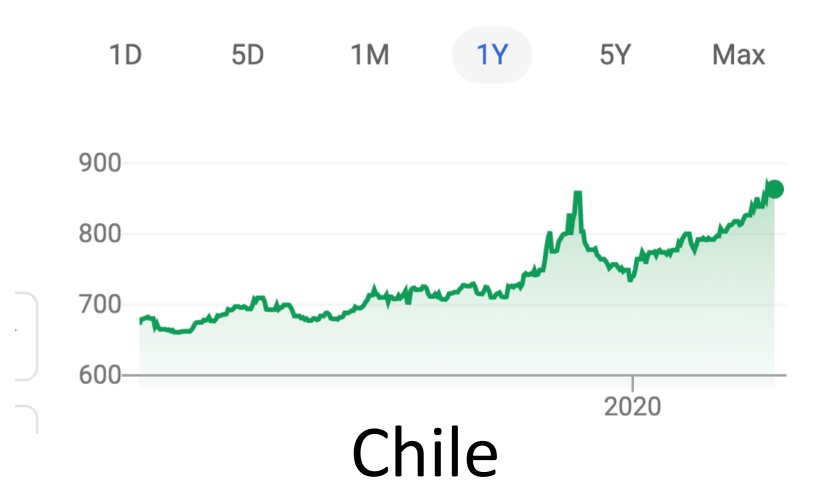
Bad temporary shocks to the
current account call for more
borrowing from abroad

So the capital market shock (sudden stop)
comes at a very bad time

All of these are shocks we have seen before

- We know, in principle, how to handle them
- Three ingredients
- Increased external (official) finance
 - Especially if the shock is temporary, as we hope this one will be
 - This facilitates making needed adjustments more gradually
- Adopt expenditure reducing policies
 - Cuts to public and private deficits through fiscal and monetary contraction to bring spending in line with lower long-term income
- Expenditure switching policies
 - To make more of the spending go to local output through e.g. real exchange rate depreciation
- Typically, no room for fiscal stimulus to cushion the decline in output, as the deficit will grow because of the negative shocks, which would
- This approach is much less efficient when many countries are in the same boat
 - Like now, which is why we need more external official finance

Countries with flexible exchange rates have seen automatic and fairly large adjustments

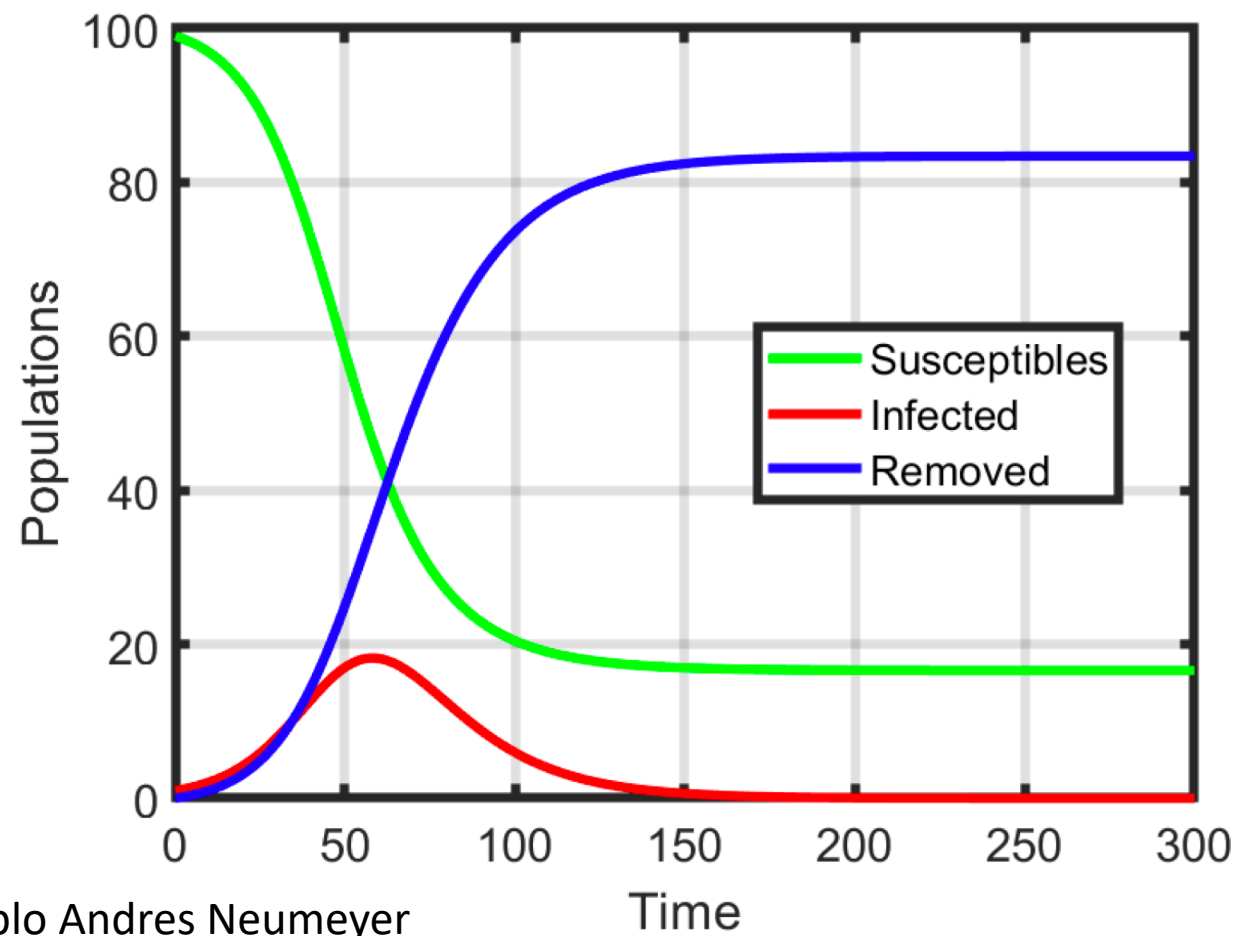
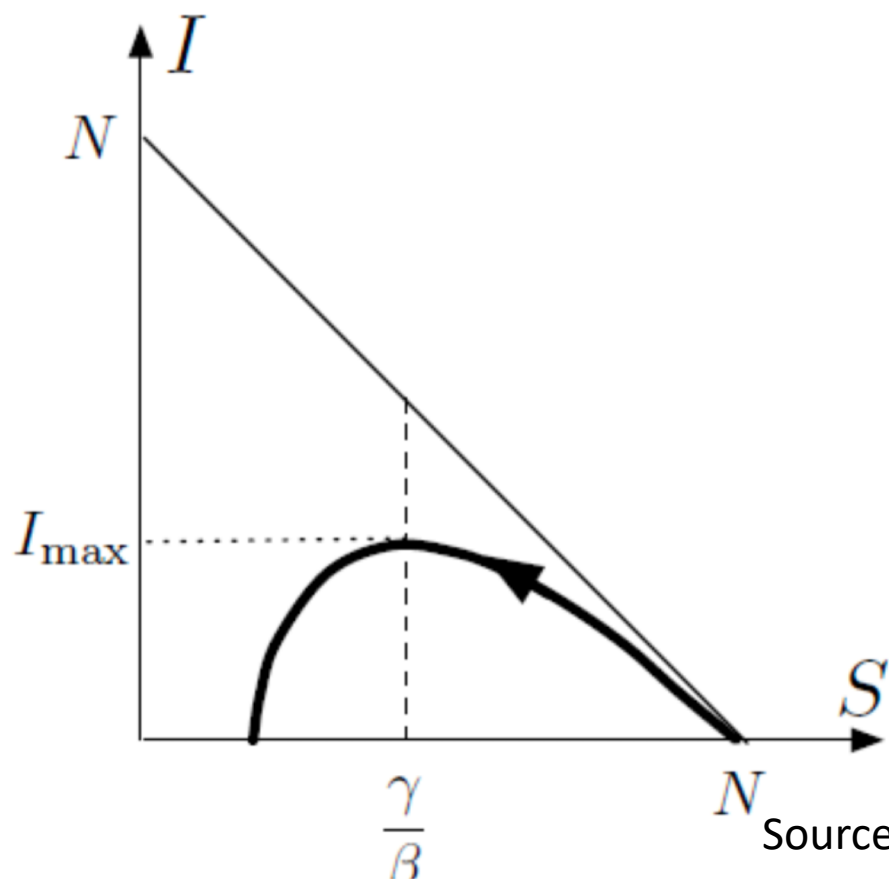
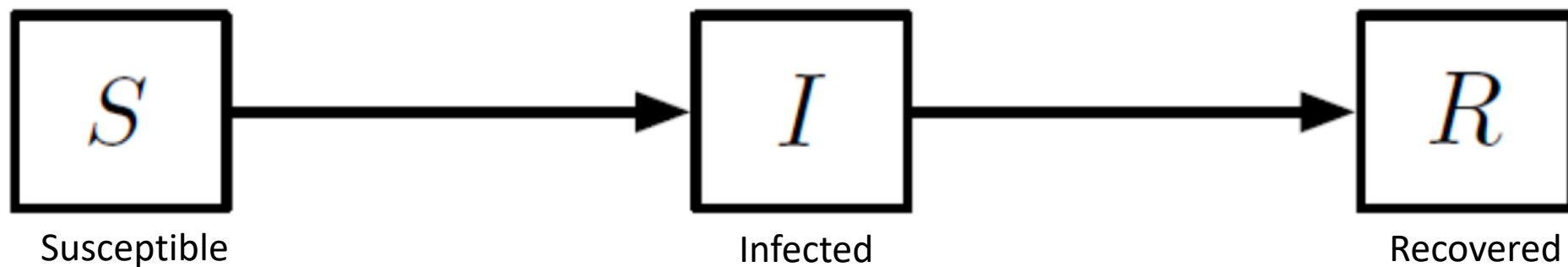


Other countries have less flexible rates

- Ethiopia and Sri Lanka have crawling pegs
- Jordan, Oman and Saudi Arabia have pegged exchange rates
- El Salvador and Panama are dollarized
- Strategies have to be reflective of this rigidity

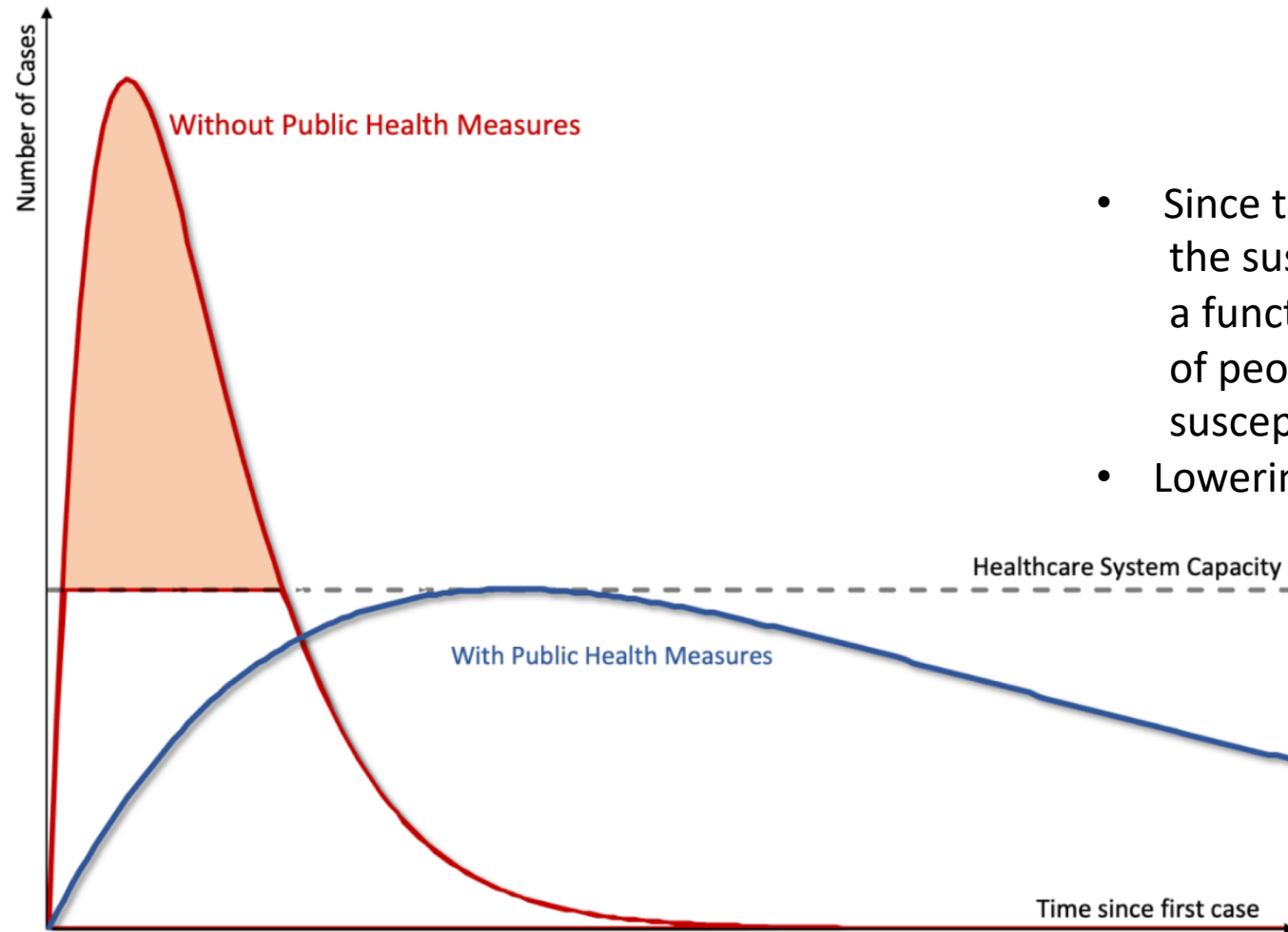
But what about Coronavirus COVID-19?

What kind of a shock is this?



Source: Pablo Andres Neumeyer

The logic of flattening the curve



- Since the infected are the ones who contaminate the susceptible, the number of infected grows as a function of the number of infected times the number of people they infect R_0 that are not immune (the susceptibles)
- Lowering R_0 flattens the curve

Figure 1: Flattening the Pandemic Curve

Source: Pierre-Olivier Gourinchas

Things to notice

- Flattening the curve means that there will be fewer cases at any point in time
- ...but it is not clear what it does to the total number of people who eventually get the disease
 - Unless it gives time to develop a vaccine
- Prevents the health care system from being overwhelmed
 - This should lower the death rate, as patients that need them, would have ventilators and ICUs
- It delays the peak of the crisis
 - Makes the process longer
- Increases the chances that by then we would have better treatment and/or a vaccine

But how do you flatten the curve?

- By restricting human activity
- Selective closures restrict parts of GDP
 - Harvard (especially Executive Education)
 - Theaters
 - Airlines
 - Bars, restaurants, gyms
- Lockdown impacts all activities
- But these decisions percolate through the economy amplifying the initial effect
 - Lay-offs, bankruptcies, non-performing loans in the banking system, supply-chain disruptions
 - Precautionary savings, delayed investment decisions cause a negative demand shock

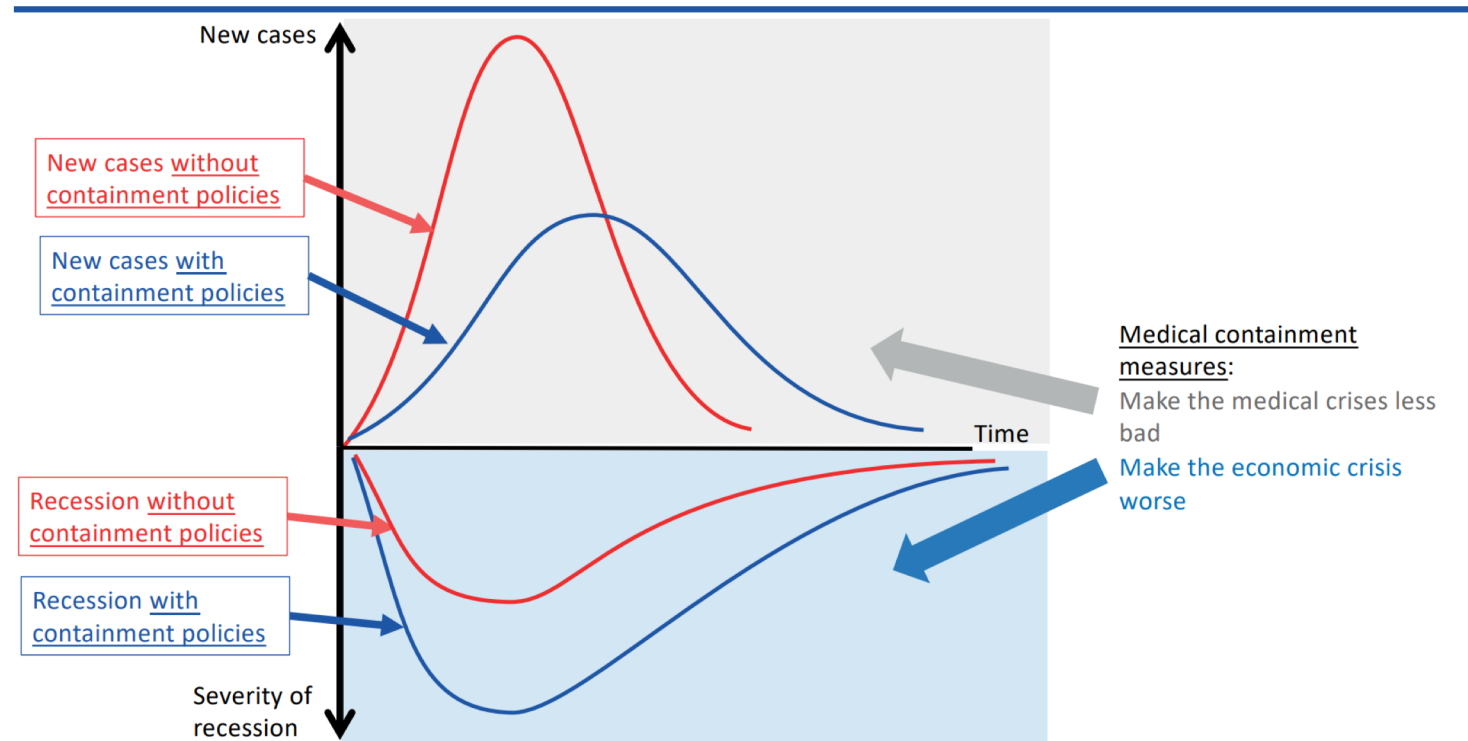
What does this mean?

- The fight against COVID-19 starts as a supply shock
 - You cannot produce
- But as it percolates through the economy, some are hit by supply shocks
 - You cannot make X because somebody did not make input Y
- Others are hit by negative demand shocks
 - Laid-off workers spend less
 - Bankrupt firms will not invest and will not be there when the crisis is over
- This amplifies the initial contraction
- While the initial shock may be hard to avoid, this amplification could be addressed
 - Protect workers, firms, banks
- ...using fiscal (i.e. public resources, capacity to borrow)

This is different from a garden-variety recession

- It is a supply shock, not a demand shock
- It percolates through both supply and demand channels
- Traditional Keynesian policies have limited effectiveness
 - More demand for theater plays does not cause more plays in a lockdown
 - These activities are not lacking in demand
- Lay-offs and bankruptcies make the recovery much slower
 - Hard to hire, hard to form new ventures
- So fiscal policy can help but not through the standard channels
 - By helping people and firms withstand the shock

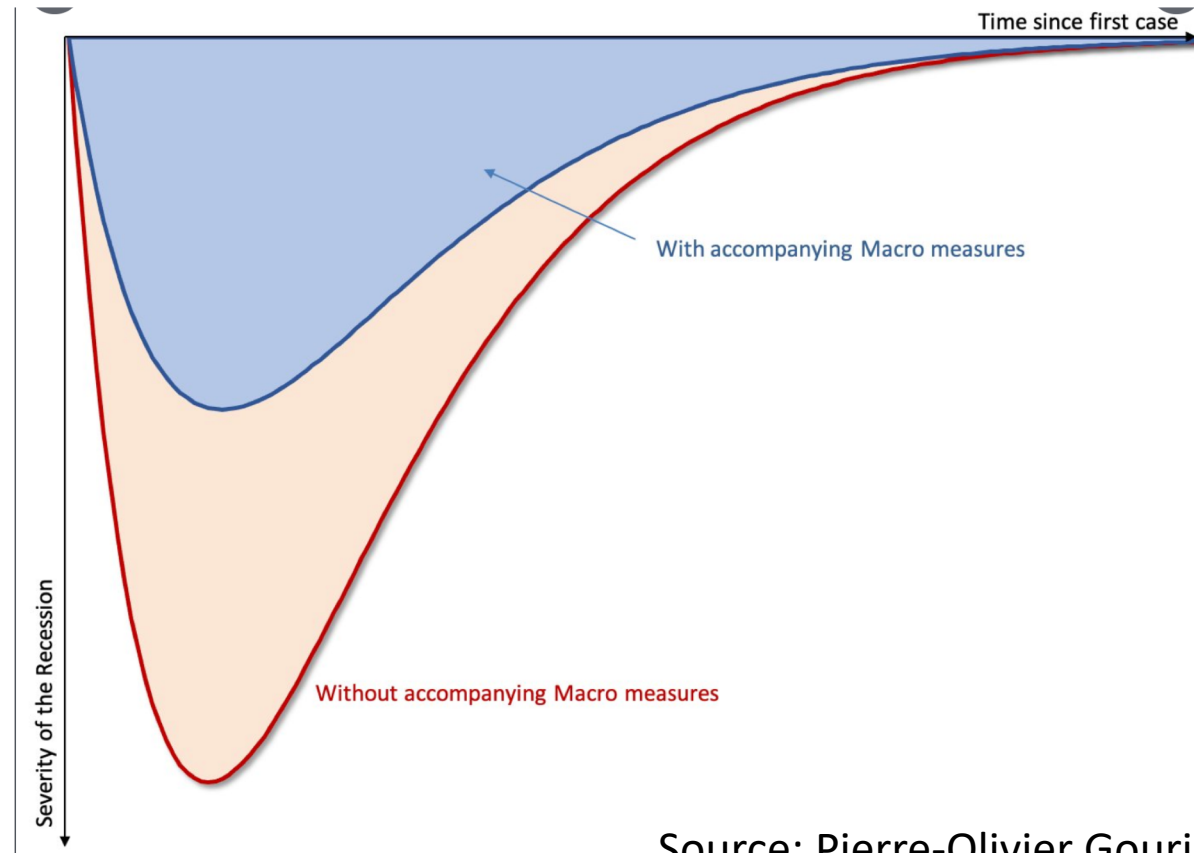
Flattening the epidemic curve worsens GDP



Source: Author's elaboration, inspired by illustrations in the chapter by Gourinchas.

Source: Richard Baldwin

The difference between the shock with and without fiscal protection



Source: Pierre-Olivier Gourinchas

So the solution seems to be clear

- Social distancing and lockdown to prevent infections
 - Bad for GDP
- Fiscal action (with monetary accommodation) to prevent the amplification and long term damage of the lockdown
 - Good for people short term
 - Good for the eventual recovery of the economy
- Typical instruments
 - Maintain payment of payroll or provide unemployment insurance
 - Provide special loans to business
 - Provide central bank loans and regulatory forbearance to banks so that they can reschedule loans

But what if countries have no fiscal space?

- Many countries are fiscally weak in good times
- With the COVID-19 shock, their fiscal space may have completely disappeared
 - tax revenues decline
 - Especially if they get a terms of trade, tourism or remittance shock
 - The crisis requires more health expenditures and ideally spending to cushion the blow
- None of this is good for the country's creditworthiness
- But if, in addition, financial markets shut down, the government may be even forced to cut back previous spending plans
- So fiscal policy cannot play the same role as in the standard recommendation, say for the US

In other words

- Without fiscal space, flattening the epidemic curve is costlier
- So countries may be forced to / “choose” not to fight the virus by as much
- ...leading to faster spread,
- ...more deaths because of lower capacity to treat
- ... and a faster end to the epidemic, assuming no re-infection
- In other words, lack of fiscal space costs lives

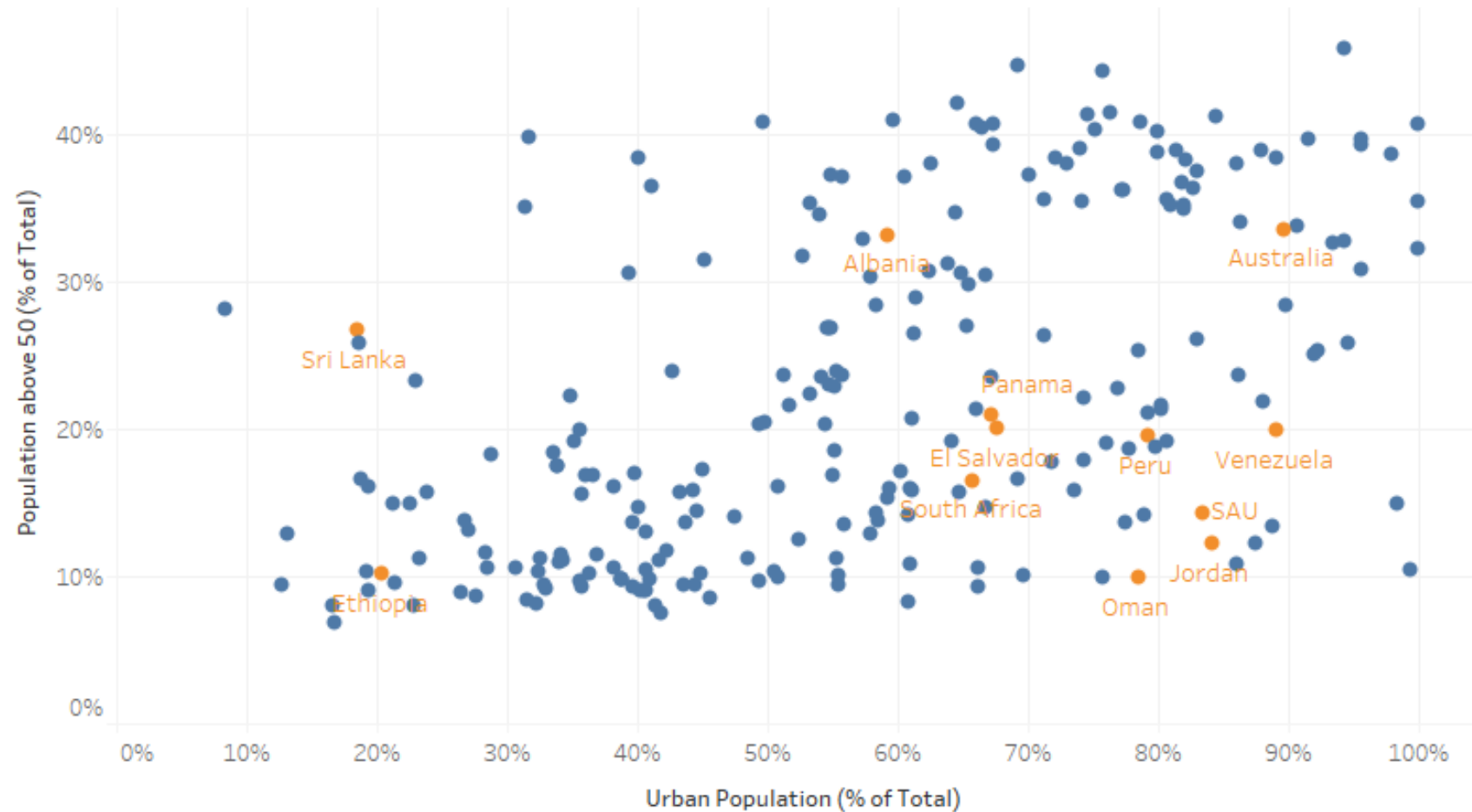
Developing countries also differ
in important health-relevant
dimensions

Developing countries tend to be different in demographic and health dimensions

- Younger
- Less urbanized
- Smaller service sectors
- Have less complex economies
 - Smaller networks of human interaction
- Have much lower GDP per capita
- Have much lower health expenditures as % of GDP
- Fewer doctors, hospital beds
- And dramatically fewer actual resources per capita
- Have less access to clean water
- Have weaker border controls

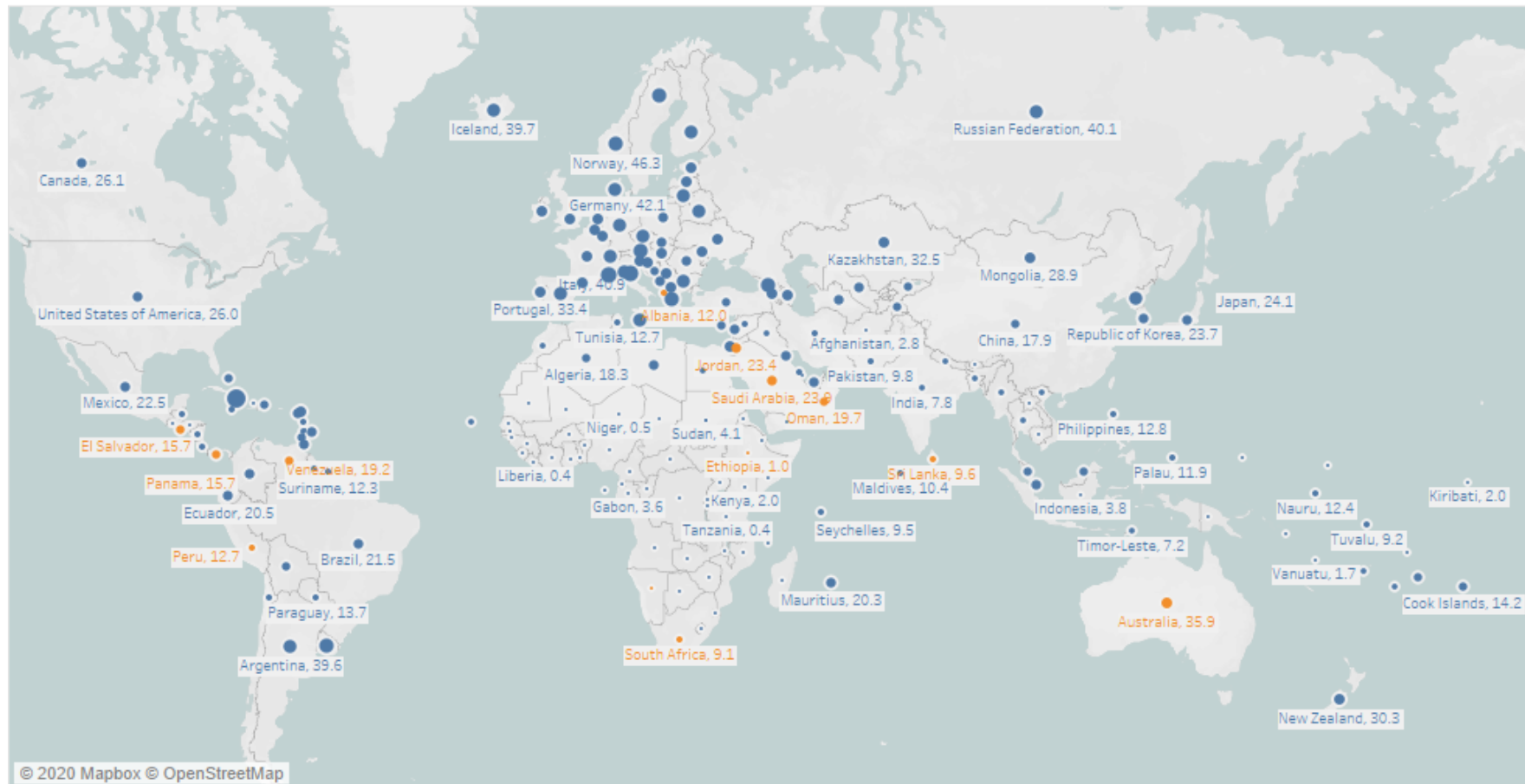
Great variations in urbanization rates and the older age %

Age and Urbanization



There is an immense gap between the health systems of developed and developing countries that will response capacities: (1) *medical doctors*

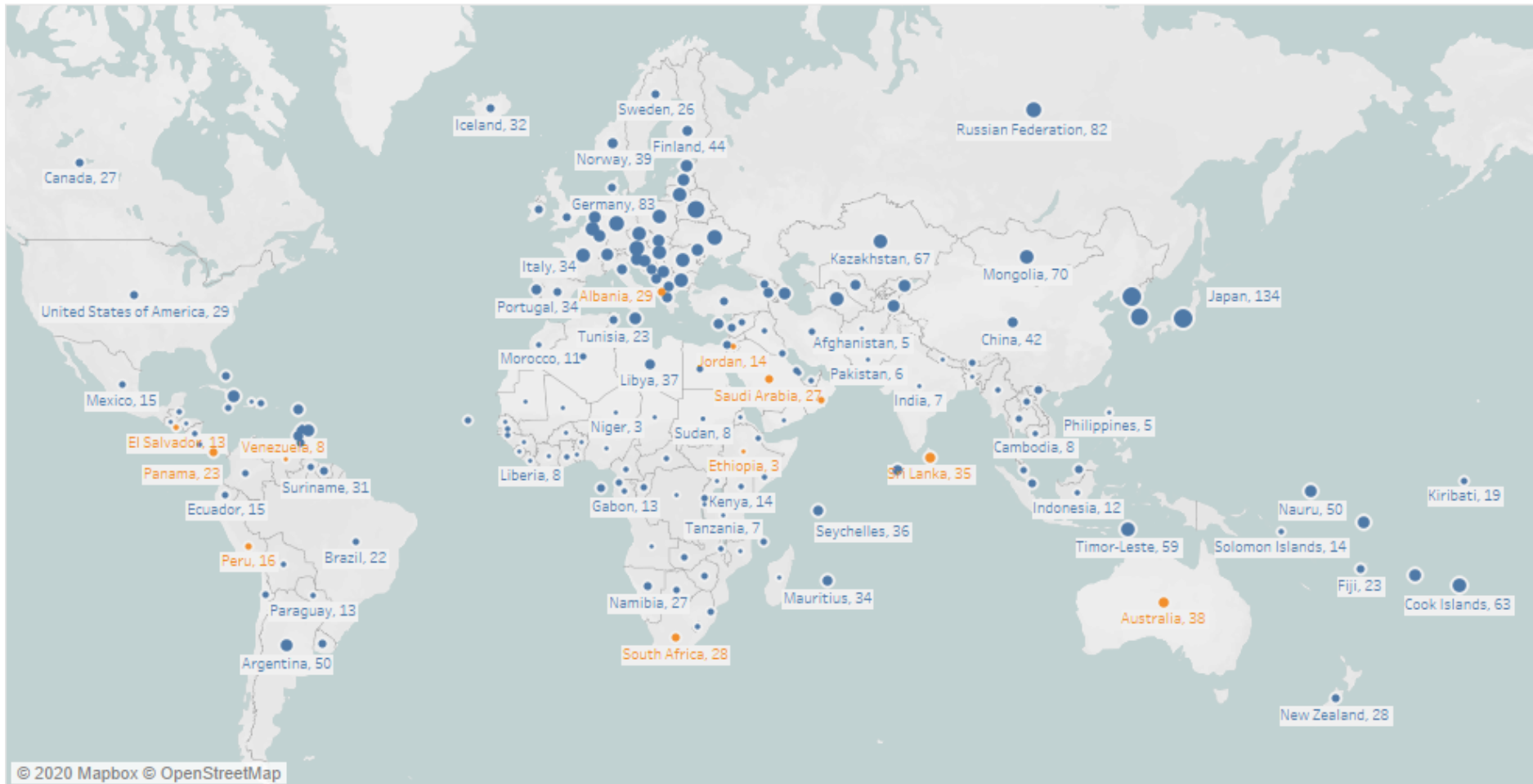
Medical Doctors (per 10,000 inhabitants)



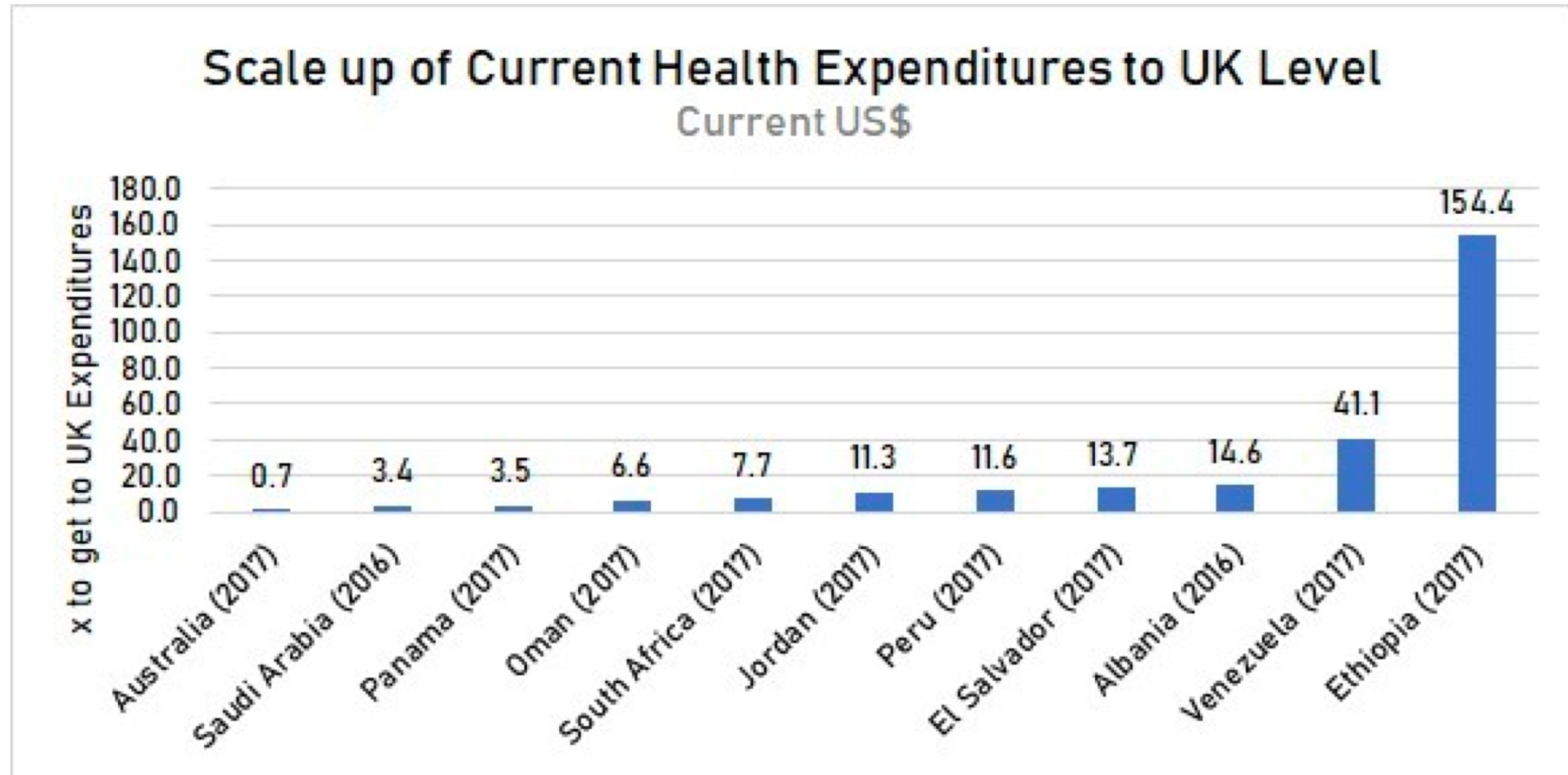
Source: WHO

There is an immense gap between the health systems of developed and developing countries that will response capacities: (2) *hospital beds*

Hospital Beds (per 10,000 inhabitants)



How much more would countries need to spend in order to reach UK spending levels?



Most countries are fighting the disease

- Countries, in spite of their small or evaporating fiscal space have nevertheless opted for lockdowns and social distancing
- How should they manage them?
- What non-pharmaceutical interventions (NPI) should they adopt?
- How should they plan to get out of the lockdown phase?
- How should they prioritize the use of their fiscal space?
- How should they think of fiscal policy in this period?

What to use the lockdown for?

- A lockdown promises to bring the trajectory of cases / deaths down, **relative to a counter-factual**
- But a lockdown is not sustainable
 - At the limit, people will have to decide between a 10% chance of dying from the virus and a 100% chance of starving to death
- Unsustainable situations cannot last
- So you will eventually need to resume production, but how?
- How can the cost of the lockdown be lowered?
- ... and how should it be shared?

Non-pharmaceutical interventions

- Generalized lockdowns are very costly because they lack or do not use information about who is susceptible, who is infected and who is immune
- They can bankrupt the economy. Countries need more information-intensive strategies
- One “poor man’s” strategy is to isolate the elderly
 - Suggested by Israel
- Other smarter strategies would require much more testing
- They would allow to:
 - 1. test a representative samples of regions, not suspicious cases
 - 2. Use this info to track the epidemic in real time
 - 3. Do serology tests to detect immunity and clear these people.
 - 4. Trace contacts of the infected and test them
- Relaxation measures should be gradual, to allow for more information to be revealed

How do you get out of a lockdown?

- Use lockdown period to invest in testing capacity and treatment capacity
 - Markets for medical inputs may become congested
- Isolate the elderly before you re-open
- Re-open activities gradually
 - Test a lot, quarantine the affected and allow others to work
 - Starting with the most critical and least “networky” activities
- Adjust speed of the re-start as more information is revealed
 - On cases, treatments, capabilities
 - Give yourself the flexibility to respond to events, do not over-commit

What to do about
macroeconomic policy?

Macroeconomic policies

- COVID-19 is a short term situation, not a permanent shock
- Create all the short-term fiscal space you can
- Your tax revenues are bound to surprise on the down side by big margins
 - ...accentuated by policies you will adopt to make the lockdown manageable
- No time to worry about prudential norms
 - Debt/GDP, rating agencies
- But know your limits and work around them
- Mobilize the maximum amount of fiscal resources you can get your hands on so you can fight COVID-19 and help people cope with it
- Ergo, borrow all that you can
- Use all the monetary sovereignty you can muster
 - Easier in countries with floating inflation-targeting regimes
 - Colombia just announced QE in spite of the oil shock and the collapse of its US\$ bonds

Creating maximum fiscal space

- Borrow all you can now with a 2-year maturity
 - If you can, from domestic markets, even if it requires monetary easing and central bank support
 - If you can, from international capital markets, 2-year duration
 - Get all the money you can from the IMF, the other IFIs are just too small
- If you are an oil importer, capture part of the oil price collapse for the government
 - Let consumers see part of the decline, but not all
- Postpone capex and other non-essential expenditures
 - Having a road 1 year later to help people in need sounds like a good trade-off

Using that fiscal space

- Health-care first and foremost
 - Make sure that the expansion is not restricted by lack of money
 - There will be plenty of other bottlenecks (doctors, imported inputs, facilities)
- Support people first, then firms. Support banks through the Central Bank
 - Make clear that these are not entitlements but emergency expenditures
- For people: no time to design new schemes, leverage the ones you have, even if they are imperfect
- Focus in particular on the informal sector
 - Learn from the El Salvador's approach: restructure payments between the informal and the formal sector (electricity, water, consumer loans)
- Leverage the banking system to support firms
 - Make it advantageous to keep workers on the payroll vis a vis firing them
 - Consider partial guarantees for banks to lend for the payroll, especially for firms affected by lockdown measures

Monetary and financial policies

- Highly dependent on exchange rate regime
- Reserves are for emergencies
 - This is an emergency
- Use the reserves to support fiscal space, even in fixed exchange rate regimes
 - With fixed XR regime, the expansion of CB domestic credit will go into lower reserves
- ... and loans to firms
 - Easier if you have state-owned banks,
 - Otherwise, negotiate partial credit guarantees for loans to firms that preserve the payroll
- Regulatory forbearance on loans that are restructured to delay payments

What should the international financial community do?

Increase fiscal space by expanding the availability of official finance

- Recirculate the flight-to-safety money that is flowing to the US
 - And causing undesired US\$ appreciation
- Quantitative Easing
 - Should Central Banks buy IFI bonds? Emerging Market bonds?
- Increase the number of countries with access to FED swap lines
 - The FED announced this policy this morning but it included only Australia, Brazil, Denmark, Korea, Mexico, Norway, New Zealand, Singapore and Sweden.
- Why only those?
 - If the concern is credit risk, maybe have those swap lines intermediated by the IMF
 - Or can the chosen countries triangulate Fed swap lines? Brazil, Australia, Sweden?
- Expand the use of existing credit facilities
 - IMF's Rapid Finance Instrument, Stand-by arrangements
 - Other IFIs are very small
- Support for dollarized economies
 - They do not have a lender of last resort
 - El Salvador, Panamá, Ecuador in my part of the world
- International fund to pay for testing, equipment and eventually vaccines (Norway)

Time is of the essence

- Let's focus on pressuring the G-7 and the G-20 for rapid financial solutions through the IMF, the Fed and the BCE
 - The others are just too small
- Let's make a big fuss about the availability of tests and treatments
 - It is the smart thing to do, to make domestic efforts more efficient and avoid re-infections
- Let's learn as quickly as we can about prevalence, treatment, monitoring and policy actions and outcomes of others

Thank you!

Raise your electronic hand to ask a question.